

General Information Letter: Gain on disposition of stock options characterized as compensation for federal income tax purposes is compensation for Illinois purposes as well and is allocated under IITA Section 304(a)(2)(B).

January 06, 2003

Dear:

This is in response to your letter dated December 18, 2002. Department of Revenue ("Department") regulations require that the Department issue only two types of letter rulings, Private Letter Rulings ("PLRs") and General Information Letters ("GILs"). PLRs are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. GILs do not constitute statements of agency policy that apply, interpret or prescribe the tax laws and are not binding on the Department. For your general information, the regulation governing the issuance of letter rulings, 2 Ill. Adm. Code Part 1200 regarding rulings and other information issued by the Department, can be accessed at the Department's website. That address is www.revenue.state.il.us/legalinformation/regs/part1200.

The nature of your question and the information provided require that we respond only with a GIL. In your letter you state as follows:

We have been asked by the above referenced taxpayers to respond to your notice dated November 4, 2002 (a copy of which is enclosed) regarding nonresident income taxes due on wages. The taxpayer (Mr. Z) was an employee of COMPANY in Illinois until retirement on July 26, 1997. As part of a bonus/deferred compensation package based on 1995 job performance only, Mr. Z received a restricted stock option granted to him on July 1, 1996. The stock was restricted for five years. After, retirement, the taxpayers moved to North Carolina during 2000 and abandoned their residency in Illinois. On July 1, 2001, the taxpayer received his stock in COMPANY. Since this was considered deferred compensation, COMPANY reported this income on a W-2 but erroneously withheld Illinois state income tax.

Since this income was deferred compensation, it falls under Illinois Regulation Section 100.3120(b)(1) and is therefore not taxable in Illinois since the compensation was not earned ratably over the appropriate period of employment as outlined in the regulation. The error in withholding Illinois state income tax was made by the payroll department of COMPANY when they used his last known employment address instead of his new place of residence in North Carolina. With this letter, we are asking that the taxpayers' 2001 nonresident return to (sic) be processed as originally filed showing no tax liability in Illinois. This will result in a net refund of \$3,389.00; the original refund requested of \$3,569.00 less the \$180.00 check issued on October 29, 2002.

Please be advised that the Department must deny the ruling you have requested.

As you have correctly pointed out, the rule governing this situation is spelled out at IIT Reg. Sec. 100.3120(b)(1). That regulation provides as follows:

- b) Compensation paid for past service

1) A federal law, P.L. 104-95 (4 USC 114), limits the power of states to impose income taxation on certain nonresident pension income. This limitation also impacts income received by a nonresident in the form of distributions from many deferred compensation plans. The allocation of distributions to nonresidents from deferred compensation plans which are not governed by that law and which are potentially income taxable in this State is governed by this subsection (b) (1). Where compensation is paid to a nonresident for past service, such compensation will, for the purpose of determining whether and to what extent such compensation is "paid in Illinois" and is allocated to Illinois under IITA 302(a), be presumed to have been earned ratably over the employee's last 5 years of service with the employer (or any predecessor or successor of the employer or a parent or subsidiary corporation of the employer), in the absence of clear and convincing evidence that such compensation is properly attributable to a different period of employment or that it is attributable to a different period of employment or that it was not earned ratably over the appropriate period of employment. Compensation earned in each past year will be deemed compensation paid in Illinois if the individual's service in such year met the tests set forth in subsection (a) above. Compensation paid for past service includes amounts paid under deferred compensation agreements where the amount of compensation is unrelated to the amount of service being currently rendered. Amounts paid to nonresidents under deferred compensation agreements may be allocated to Illinois under IITA Section 302(a) in accordance with this paragraph notwithstanding the fact that amounts paid to nonresidents under such agreements will be deemed not to be compensation paid in Illinois for purposes of IITA Section 701 and will not be subject to withholding (see Section 100.7010(g)).

In your correspondence, you have admitted/stated that "The taxpayer (Mr. Z) was an employee of COMPANY **in Illinois** until retirement on July 26, 1997." You also indicate that the deferred compensation benefits were payable "based on 1995 job performance only..." Finally, you declare that "(a)fter retirement, the taxpayers moved to North Carolina during 200 and abandoned their **residence in Illinois**." We leave aside the question of whether you have presented "clear and convincing evidence that the compensation in question is properly attributed to a different period of employment..." as contemplated under IIT Reg. Sec. 100.3102(b)(1), since that issue does not impact the result herein. Taking your statements at face value, the income in question, though paid on a deferred basis, would be attributable to a year in which the taxpayer was an Illinois resident regardless of whether it is attributed ratably over the last 5 years of his employment or is specifically allocated to the year 1995. Under IITA 301(a), "(a)ll items of income or deduction which were taken into account in the computation of base income for the taxable year by a resident **shall be allocated to this State**." (emphasis added). Thus, all of the deferred compensation income described in your correspondence is properly allocable to and taxable by Illinois. For your information, the regulation in question would be more properly invoked in a situation where the taxpayer had his place of employment in more than one state during the last 5 years of his tenure with the employer paying the deferred compensation.

The ruling requested in your correspondence is hereby denied. The Department stands by its Notice issued 11/4/02. The correct refund amount is \$180.00. If you wish to contest this position, you may file an amended return on behalf of your clients requesting a refund of the disputed amount. Once the claim is denied, as we will recommend it should be based on the facts you have asserted, you may invoke your clients' rights to administrative review.

As stated above, this is a GIL which does not constitute a statement of policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department. If you wish to obtain a PLR which will bind the Department with respect to the application of the law to specific facts, please submit a request conforming to the requirements of 2 Ill. Adm. Code Part 1200.

Sincerely yours,

Jackson E. Donley,
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